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No. 94 Original

In the Supreme Court of the United States

OCTOBER TERM, 1982

STATE OF SOUTH CAROLINA, PLAINTIFF

v.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA

ON MOTION FOR LEAVE TO FILE COMPLAINT

BRIEF FOR THE DEFENDANT IN OPPOSITION

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QUESTIONS PRESENTED

Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 596, amending Section 103 of the Internal Revenue Code of 1954, 26 U.S.C., provides that the interest on certain obligations of a state or political subdivision shall be excluded from gross income only if the obligations are issued in registered form.

The questions presented are whether South Carolina's suit for a declaration that Section 310(b)(1) violates the Tenth Amendment and for an order enjoining its enforcement to prevent the Secretary of the Treasury from assessing taxes on the interest from unregistered state and local obligations is barred by the tax exception to the Declaratory Judgment Act, 28 U.S.C. (Supp. V) 2201, and the Anti-Injunction Act, 26 U.S.C. (Supp. V) 7421(a), and whether that provision is constitutional.

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JURISDICTION

The original jurisdiction of this Court is invoked under Article III, Section 2, of the Constitution and 28 U.S.C. (Supp. V) 1251. As we shall show (pp. 4-11, *infra*), however, the action in its present form cannot be maintained because the relief sought by South Carolina is barred by statute. At all events, since this suit is one between a state and United States, the jurisdiction of this Court is not exclusive under 28 U.S.C. (Supp. V) 1251(b)(2), and we urge denial of the motion for leave to file.

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATION INVOLVED

Article I, Section 8, Article III, Section 2, and Article VI of the United States Constitution; Section 7421 of the Internal Revenue Code of 1954, 26 U.S.C. (& Supp. V); 28 U.S.C. (Supp. V) 2201; Section 310 of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96

Stat. 595; and Temp. Income Tax Reg. § 5f.103-1, T.D. 7852, 47 Fed. Reg. 51361 (1982), are set forth, in relevant part, in the App., *infra*, 1a-15a.

STATEMENT

1. The State of South Carolina seeks leave to file its complaint to enjoin the Secretary of the Treasury from enforcing Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 596 ("1982 Tax Act") insofar as it includes in taxable income of the holders, interest on unregistered general obligations of South Carolina issued after June 30, 1983, and to obtain a declaration that Section 310(b)(1) as so applied is unconstitutional (Mot. 8-9).

The complaint asserts that as one of its essential sovereign functions, South Carolina must borrow money to function effectively as a provider of services essential to its citizens and that, pursuant to Article X, Section 13 of the South Carolina Constitution of 1895 as amended, it is authorized to borrow money and to issue general obligation and other bonds (Mot. 4).

South Carolina further alleges that, after June 30, 1983,[1] Section 310(b)(1) impermissibly imposes conditions upon its sovereign power to borrow money and unconstitutionally impairs the ability of South Carolina to function as a sovereign in violation of the Tenth Amendment (Mot. 5-6).[2]

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[1]Under Section 310(d) (96 Stat. 599), the original effective date of the statute was with respect to obligations issued after December 31, 1982. However, pursuant of Sections 306(b)(2) and 311(d) of the Technical Corrections Act of 1982, Pub. L. No. 97-448, 96 Stat. 2405-2406 and 2412, the effective date was postponed to cover only obligations issued after June 30, 1983.

[2]The complaint (Mot. 6) incorporates by reference an affidavit of the Treasurer of the State of South Carolina, who estimated (*id.* at 16) that if the State were to evidence its borrowings by fully registered bonds it

2. Section 310(b)(1) is not an isolated provision. Rather, it is but one of a number of the provisions of Section 310 (App., *infra*, 3a-6a), by which Congress has sought comprehensively to deal with problems growing out of the existence of bearer bonds, usually with coupons attached, and to bring more nearly to completion the movement away from bearer bonds toward the issuance of registered bonds that began after 1962. It is the common, but not universal, practice currently to issue corporate bonds in registered form.

The principal provisions of Section 310 are as follows: Section 310(a) (96 Stat. 595) amends the Second Liberty Bond Act (31 U.S.C. 757c-5) to provide that, with certain exceptions not relevant here,[3] every obligation of the United States, or of any agency or instrumentality thereof, shall be in registered form.[4] Section 310(b)(1) (96 Stat. 596) adds

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would pay an additional 0.25% interest on its borrowings, while bonds without tax-exempt status would require payment of "approximately 3% to 5% more by way of interest rates" (*id.* at 16-18).

[3]Non-exempted obligations are termed "registration-required obligation," a term that appears in, and is defined in, most of the subsections of Section 310. While the definition varies in the particular statutory context, a composite summary of the statutory definition of "registered-required obligation" is: any obligation other than an obligation which (1) is issued by a natural person; (2) is not of a type issued to the public; (3) has a maturity (at issue) of not more than one year; (4) is the subject of arrangements reasonably designed to ensure that it will be sold (or resold in connection with the original issue) only to a person who is not a United States person; or (5) has interest payable only outside the United States and its possessions and bears on its face a statement that any United States person holding such obligation will be subject to limitations under United States income tax laws.

[4]Each subsection of Section 310 permits "book-entry registration," under which a transfer of the right to principal and interest may be made by book entries, consistent with regulations prescribed by the Secretary. There are existing regulations concerning registration of United States securities (31 C.F.R. 306.2(n), 306.10-306.13) and book-entry procedures (31 C.F.R. 306.115-306.122). Cf. 12 C.F.R. 811.0-811.7.

a new subsection (j) to Section 103 of the 1954 Code to provide that Section 103(a) shall not provide an exemption from federal income tax for interest on any registration-required obligation that is not issued in registered form.[5] Section 310(b)(2) (96 Stat. 596) amends Section 163 of the 1954 Code to deny a deduction for interest paid or accrued on any registration-required obligation not in registered form. Section 310(b)(3) (96 Stat. 597) amends Section 312 of the 1954 Code to provide that the earnings and profits of any corporation (other than certain foreign corporations) shall not be decreased by reason of a payment of interest with respect to which the amendment to Section 163 denies an interest deduction. Section 310(b)(4) (96 Stat. 597) imposes on any person (other than a state or political subdivision thereof) issuing a registration-required obligation not in registered form an excise tax equal to the product of 1% of its principal amount multiplied by the number of years from issuance to its maturity. Section 310(b)(5) (96 Stat. 598) amends Section 165 of the 1954 Code to deny deductions for losses on registration-required obligations that are not issued in registered form. Finally, Section 310(b)(6) (96 Stat. 599) amends Section 1232 of the 1954 Code to provide that gain on the sale or other disposition of a registration-required obligation not issued in registered form shall be treated as ordinary income rather than as capital gain unless the issuance of the obligation was subject to the excise tax imposed by Section 310(b)(4).

ARGUMENT

A. THIS SUIT IS BARRED BY STATUTE

1. This suit—to enjoin the assessment and collection of income taxes, and to obtain a declaratory judgment with respect to taxes—is prohibited by statute. Section 7421(a)

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[5]Temp. Income Tax Reg. § 5f.103-1, T.D. 7852, under Section 103(j) of the 1954 Code (Section 310(b)(1) of the 1982 Tax Act, published in the Federal Register on November 15, 1982 (47 Fed. Reg. 51361), are set forth in the App., *infra*, 12a-15a

of the Internal Revenue Code of 1954, 26 U.S.C. (Supp. V) (App., *infra*, 2a), commonly known as the Anti-Injunction Act, provides, with exceptions not here relevant, that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person". Moreover, while the Declaratory Judgment Act, 28 U.S.C. (Supp. V) 2201 (App., *infra*, 2a-3a), authorizes "any court of the United States" to issue, in appropriate cases, declaratory judgments, it contains an explicit exception "with respect to Federal taxes." Cf. *Bob Jones University* v. *Simon*, 416 U.S. 725 (1974); *Commissioner* v. *"Americans United" Inc.*, 416 U.S. 752 (1974).[6]

The statutory prohibitions against suits "in any court" by any person to enjoin the assessment or collection of taxes and against declaratory judgments with "respect to Federal taxes" do not deprive any taxpayer of complete and effective judicial review of his liability for taxes. Cf. *Bob Jones*

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[6]The statutory exception to the "Federal taxes" limitation on declaratory judgments, *i.e.*, "other than actions brought under section 7428 of the Internal Revenue Code of 1954," refers to the authorization, enacted after the above-cited decisions of this Court, for a determination by the United States Tax Court, the United States Claims Court, or the United States District Court for the District of Columbia, of the initial or continuing classification of an organization as an exempt organization pursuant to Section 501(c)(3) of the 1954 Code.

Section 7478, added to the 1954 Code by Section 336 of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2841, authorizes a determination with respect to obligations proposed to be issued by a state or political subdivision thereof, on petition of the prospective issuer and only in the first instance by the Tax Court, "whether such prospective obligations are described in section 103(a)." Section 103(a) of the Internal Revenue Code of 1954 is the provision that excludes from gross income interest on obligations of states and political subdivision thereof. Since "described in section 103(a)" limits the scope of the proceeding to issues of statutory coverage or construction, Section 7478 of the 1954 Code does not authorize in a declaratory judgment action, even in the Tax Court, consideration and determination of such issues as are sought to be advanced here by South Carolina.

University v. *Simon, supra*, 416 U.S. at 746-748. South Carolina is not a taxpayer, but seeks to enjoin collection of income taxes from others,[7] and to have a declaration of the liability of others. Any taxpayer holding obligations of South Carolina may fully and freely litigate the correctness of his income tax liabilities in either the United States Tax Court, a district court of the United States, or the United States Claims Court, and may raise any appropriate constitutional issue. See Sections 6213(a), 7422; 28 U.S.C. 1346(a)(1), 1491; *Flora* v. *United States*, 362 U.S. 145 (1960). This statutory scheme provides a fully adequate procedure for judicial review of tax liability that contemplates no such litigation as South Carolina here seeks to initiate. Hence, South Carolina cannot invoke the jurisdiction of any court, much less the original but not exclusive jurisdiction of this Court under 28 U.S.C. (Supp. V) 1251(b)(2), either to enjoin the assessment or collection of taxes or to obtain a declaratory judgment with respect to taxes.

2. The only exception to the bar of the Anti-Injunction Act is where the taxpayer can show that equity jurisdiction would otherwise be available, and that under no circumstances could the government prevail on the merits of its claim. *Bob Jones University* v. *Simon, supra*, 416 U.S. at 737; *Enochs* v. *Williams Packing & Navigation Co.*, 370 U.S. 1, 7 (1962). That is not the case here. The registration requirement imposed by Section 310 of the 1982 Tax Act is a necessary and proper exercise of several powers granted Congress under Article I of the United States Constitution.

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[7]Section 7421(a) prohibits suits "by any person" to enjoin assessment or collection of taxes, "whether or not such person is the person against whom such tax was assessed." See *Bob Jones University* v. *Simon, supra*, 416 U.S. at 739.

While the statute has long provided that the interest earned on certain[8] state obligations is exempt from federal income taxation, not all transactions with such obligations are exempt from tax. Thus, the gain realized on the sale of such obligations is as taxable as any other capital transaction (*Willcuts* v. *Bunn*, 282 U.S. 216 (1931)), and the transfer of such obligations by gift or at death may give rise to liability for gift or estate taxes. In reporting Section 310 of the 1982 Tax Act,[9] the Senate Finance Committee (1 S. Rep. No. 97-494, 97th Cong., 2d Sess. 242 (1982)) stated:

> The committee believes that a fair and efficient system of information reporting and withholding cannot be achieved with respect to interest-bearing obligations as long as a significant volume of long-term bearer

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[8]Although it is not necessary to address the merits of South Carolina's suit at this time, the authorities seriously question the premise underlying its complaint, viz., that the Constitution requires federal tax exemption on the interest on state obligations. See, *e.g.*, Senate Spec. Comm. on Taxation of Governmental Securities and Salaries, *Taxation of Governmental Securities and Salaries*, S. Rep. No. 2140 (Pt. 1), 76th Cong., 3d Sess. (1940); Kirby, *State and Local Bond Interest*, in 1 House Comm. on Ways and Means, *Tax Revision Compendium* 679 (Comm. Print Nov. 16, 1959). Compare *Graves* v. *New York ex rel. O'Keefe*, 306 U.S. 466 (1939); *Helvering* v. *Gerhardt*, 304 U.S. 405 (1938); and *Helvering* v. *Mountain Producers Corp.*, 303 U.S. 376 (1938); with *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895). Indeed, the interest earned on a number of state obligations (*e.g.*, industrial development bonds and arbitrage bonds) is now subject to federal income tax. See Internal Revenue Code of 1954, 26 U.S.C. (& Supp. V) 103(b) through 103(i).

[9]The provisions that became Section 310 were originally set forth in Section 312 of the Senate Bill. See also H.R. Conf. Rep. No. 97-760, 97th Cong., 2d Sess. 563-565 (1982), and Staff of the Jt. Comm. on Taxation, 97th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982*, 189-193 (Jt. Comm. Print 1982).

> instruments is issued. A system of book-entry registration will preserve the liquidity of obligations while requiring the creation of ownership records that can produce useful information reports with respect to both the payment of interest and the sale of obligations prior to maturity through brokers. Furthermore, registration will reduce the ability of noncompliant taxpayers to conceal income and property from the reach of the income, estate, and gift taxes. Finally, the registration requirement may reduce the volume of readily negotiable substitutes for cash available to persons engaged in illegal activities.

What is more, registration of securities will deter violations of 18 U.S.C. 2314 and 2315, dealing with the transportation and disposition of stolen or forged securities, and will facilitate apprehension of violators.

There can be no doubt that Congress can require registration of securities, whoever the issuer, in aid of the exercise of its enumerated powers under Article I. The only question remaining, therefore, is whether despite the explicit terms of the Supremacy Clause of Article VI of the United states Constitution, Section 310(b)(1) imposes an impermissible burden upon the exercise of a necessary function of state government. We believe it does not.

This Court determined long ago that when Congress, pursuant to constitutionally granted authority, controls through taxation specified forms of securities, any state or municipality that chose to exercise its borrowing power through the issuance of securities in those forms did so subject to the tax that Congress had imposed. *National Bank* v. *United States*, 101 U.S. 1 (1880). Not every extension of credit to a government evokes constitutional protection from taxation. Cf. *Smith* v. *Davis*, 323 U.S. 111 (1944). The requirement that securities be issued in registered form if the interest from such securities is to be tax-

exempt in the hands of the lender does not restrict the state's borrowing power. It is not discriminatory against state obligations, since registration is required of similar obligations of the United States, and unregistered corporate obligations deny the issuer an income tax deduction for interest paid and also impose a substantial excise tax.

The Treasurer of South Carolina "estimates" that registration would add 0.25% in interest to the cost of issuance (Mot. 16). But this "estimate" ignores offsetting economies of handling and insurance, resulting from reduced risk of loss or theft, that add to the attractiveness of registered bonds. Indeed, the Treasurer's "estimate" is difficult to reconcile with the fact that corporate issuers in the past 20 years have substantially moved from bearer coupon bonds to registered bonds and that Treasury Bills are now issued in registered form, induced in each case only by considerations of economy and efficiency. See Sebring, *Foreward* to ABA, *Corporate Debt Financing Project* at 1-8 (1967).

In the collection of federal revenues, which are not without many benefits to the states, Congress may require that the state or local governments collect and remit federal taxes on admissions to public parks.[10] It may require that a state officer and a state withhold from the compensation of a state employee the amounts by which the employee was

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[10] *Wilmette Park District* v. *Campbell*, 338 U.S. 411 (1949). The Court has very recently repeated an earlier reference to the management of state parks as clearly a traditional state function. *EEOC* v. *Wyoming*, No. 81-554 (Mar. 2, 1983), slip op. 11; *National League of Cities* v. *Usery*, 426 U.S. 833, 851 (1976).

delinquent in payment of federal taxes,[11] just as the Internal Revenue Code requires that state and local governments withhold and remit current income taxes from the compensation of their employees.[12] Congress may require that a state cover public employees in its unemployment insurance statutes on pain of losing administrative grants and losing also credits to private employers against the federal unemployment tax for contributions to the state's unemployment fund.[13]

The uniform burden borne by nation, states, and corporations incident to the issuance of registered obligations, if there are such burdens, is no greater than the burden incident to employment of the personnel of state government, and touches upon no more central or vital interests. South Carolina has suggested no substantive interest it may have in the issuance of bearer, rather than registered, obligations. Indeed, Section 310(b)(1) does not, in fact, limit, modify, or qualify a state's borrowing power quantitatively or qualitatively. It does not deny to a state's obligations the preferential access to the capital markets resulting from income tax exemption of the interest on those obligations, as do the provisions of Section 103(b)(1) and (c)(1) with respect to industrial development bonds and arbitrage bonds. It does provide, in furtherance of the effective use of the nation's taxing and other powers committed to Congress, that if a state wishes to offer to its lenders the attractive feature of income-tax exemption with respect to the interest on its obligations, it must issue those obligations in registered form.

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[11] *Sims* v. *United States*, 359 U.S. 108 (1959); *Massachusetts* v. *United States*, 296 F.2d 336 (1st Cir. 1961).

[12] 26 U.S.C. (& Supp. V) 3402(a) and 26 U.S.C. 3404.

[13] *New Hampshire* v. *Marshall*, 616 F.2d 240 (1st Cir.), appeal dismissed, 449 U.S. 806 (1980); *County of Los Angeles* v. *Marshall*, 631 F.2d 767 (D.C. Cir.), cert. denied, 449 U.S. 837 (1980).

South Carolina "claim[s] no substantial stake" in issuing its securities in bearer, or unregistered, form other than problematic costs which, "even if they were not largely speculative in their own right" (*EEOC* v. *Wyoming*, No. 81-554 (Mar. 2, 1983), slip op. 13), are entirely comparable to costs incident to employment of state officers and employees that co-existence with the nation requires of the states in the federal union. In sum, there is no serious basis for a claim that South Carolina must be enabled to issue unregistered, rather than registered obligations as an "undoubted attribute of state sovereignty" (*National League of Cities* v. *Usery*, 426 U.S. 833, 845 (1976)), and the proposed complaint accordingly sets forth no arguably substantial constitutional challenge to Section 310(b)(1). *EEOC* v. *Wyoming, supra*; *FERC* v. *Mississippi*, 456 U.S. 742 (1982); *Hodel* v. *Virginia Surface Mining & Reclamation Ass'n*, 452 U.S. 264, 286-288 (1981).

B. IN THE EXERCISE OF ITS DISCRETION, THIS COURT SHOULD DECLINE TO ENTERTAIN THIS SUIT

At all events, even if South Carolina's proposed suit were not barred by the statute, we submit its motion for leave to file a complaint should nevertheless be denied. The complaint is not one alleging a case or controversy between two states within the exclusive jurisdiction of this Court, under 28 U.S.C. (Supp. V) 1251(a), but a dispute between the United States and a state over which this Court has original but not exclusive jurisdiction under 28 U.S.C. (Supp. V) 1251(b)(2). This Court exercises its original jurisdiction sparingly and is particularly reluctant to take jurisdiction of a suit which is not within the exclusive original jurisdiction of the Court. *United States* v. *Nevada*, 412 U.S. 534, 538 (1973); *Illinois* v. *City of Milwaukee*, 406 U.S. 91 (1972); *Ohio* v. *Wyandotte Chemicals Corp.*, 401 U.S. 493 (1971). In our view, South Carolina has failed to show that the

present case qualifies as one of the exceptional situations in which this Court should exercise its extraordinary original jurisdiction.

Assuming arguendo that South Carolina's suit lies in any court, this case is particularly inappropriate for the exercise of this Court's discretionary original jurisdiction. First, given the demands on this Court's original and appellate docket, it seems plain that a district court could hear the case more promptly. This is especially true in light of the fact that to support its claim, South Carolina would undoubtedly seek to introduce evidence of the actual burden imposed upon it by the federal tax statute. Such a proceeding could be more expeditiously conducted at the usual trial court level by a federal district court. Finally, neither the jurisdictional questions nor the constitutional questions presented in this case are of such urgent concern to the entire country as to require a definitive resolution by this Court in the first instance. Cf. *South Carolina* v. *Katzenbach*, 383 U.S. 301, 307 (1966). Hence, in the exercise of its discretion, this Court should decline to entertain this suit.

CONCLUSION

The motion for leave to file a complaint should be denied.

Respectfully submitted.

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APPENDIX

CONSTITUTION OF THE UNITED STATES:

ARTICLE I

* * * * *

Section 8. The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

To borrow Money on the credit of the United States;

To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

* * * * *

To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures;

* * * * *

To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

ARTICLE III

* * * * *

Section 2. The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority;—to all Cases affecting Ambassadors, others public ministers and Consuls;—to all Cases of admiralty and maritine Jurisdiction;—to Controversies to which the United States shall be a Party;—to Controversies between two or more States;—between a State and Citizens of another State;—between Citizens of different

States;—between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the supreme Court shall have original Jurisdiction. In all other Cases before mentioned, the supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make.

ARTICLE VI

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This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, and Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Internal Revenue Code of 1954, 26 U.S.C. (Supp. V):

Section 7421. PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION.

(a) Tax.—Except as provided in sections 6212(a) and (c), 6213(a), 6672(b), 6694(c), and 7426(a) and (b)(1), and 7429(b), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person against whom such tax was assessed.

28 U.S.C. (Supp. V) 2201. Creation of remedy

In a case of actual controversy within its jurisdiction, except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of

1954 * * * any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such. Section 310, Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, 595:

Section 310. OBLIGATIONS REQUIRED TO BE REGISTERED.

(a) UNITED States obligations.—The Second Liberty Bond Act is amended by adding at the end thereof the following new section:

"SEC. 28. (a) Every registration—required obligation of the United States (or of any agency or instrumentality thereof) shall be in registered form.

"(b) For purposes of this section—

"(1) Except as provided in paragraph (2), the term 'registration-required obligation' means any obligation other than obligation which—

"(A) is not of a type offered to the public, or

"(B) has a maturity (at issue) of not more than 1 year.

"(2) The term 'registration-required obligation' shall not include any obligation if—

"(A) there are arrangements reasonably designed to ensure that such obligation will be sold (or resold in connection with the original issue) only to a person who is not a United States person, and

"(B) in the case of an obligation not registered form—

"(i) interest on such obligation is payable only outside the United States and its possessions, and

"(ii) on the face of such obligation there is a statement that any United States person who holds such obligation will be subject to limitations under the United States income tax laws.

"(c)(1) For purposes of subsection (a), a book entry obligation shall be treated as in registered form if the right to principal of, and stated interest on, such obligation may be transferred only through a book entry consistent with regulations prescribed by the Secretary of the Treasury.

"(2) The Secretary of the Treasury shall prescribe such regulations as may be necessary to carry out the purpose of subsection (a) where there is a nominee or chain of nominees."

(b) OTHER OBLIGATIONS.—

(1) OBLIGATIONS MUST BE IN REGISTERED FORM TO BE TAX-EXEMPT.—Section 103 (relating to interest on certain governmental obligations) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) OBLIGATIONS MUST BE IN REGISTERED FORM TO BE TAX-EXEMPT.—

"(1) IN GENERAL.—Nothing in subsection (a) or in any other provision of law shall be construed to provide an exemption from Federal tax for interest on any registration-required obligation unless the obligation is in registered form.

"(2) REGISTRATION-REQUIRED OBLIGATION.—The term 'registration-required obligation' means any obligation other than an obligation which—

"(A) is not of a type offered to the public,

"(B) has a maturity (at issue) of not more than 1 year, or

"(C) is described in subsection 163(f)(2)(B).

"(3) SPECIAL RULES.—

'(A) BOOK ENTRIES PERMITTED.—For purposes of paragraph (1), a book entry obligation shall be treated as in registered form if the right to the principal of, and stated interest on, such obligation may be transferred only through a book entry consistent with regulations prescribed by the Secretary.

"(B) NOMINEES.—The Secretary shall prescribe such regulations as may be necessary to carry out the purpose of paragraph (1) where is a nominee or chain of nominees."

(2) DENIAL OF DEDUCTION FOR INTEREST IF OBLIGATION NO IN REGISTERED FORM.—Section 163 (relating to deduction for interest) is amended by redesignating subsection (e) the following new subsection:

"(f) DENIAL OF DEDUCTION FOR INTEREST ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—

"(1) IN GENERAL.—Nothing in subsection (a) or in any other provision of law shall be construed to provide a deduction for interest on any registration—required obligation unless such obligation is in registered form.

"(2) REGISTRATION-REQUIRED OBLIGATION.—For purposes of this section—

"(A) IN GENERAL.—The term 'registration-required obligation' means any obligation (including any obligation issued by a governmental entity) other than an obligation which—

"(i) is issued by a natural person,

"(ii) is not of a type offered to the public,

"(iii) has a maturity (at issue) of not more than 1 year, or

"(iv) is described in subparagraph (B).

"(B) CERTAIN OBLIGATIONS NOT INCLUDED.—An obligation is described in this subparagraph if-

"(i) there are arrangements reasonably designed to ensure that such obligation will be sold (or resold in connection with the original issue) only to a person who is not a United States person, and

(ii) in the case of an obligation not in registered form—

"(I) interest on such obligation is payable only outside the United States and its possessions, and

"(II) on the face of such obligation there is a statement that any United States person who holds such obligation will be subject to limitations under the United States income tax laws.

"(C) AUTHORITY TO INCLUDE OTHER OBLIGATIONS.—Clauses (ii) and (iii) of subparagraph (A), and subparagraph (B), shall not apply to any obligation if-

"(i) such obligation is of a type which the Secretary has determined by regulations to be used frequently in avoiding Federal taxes, and

(ii) such obligation is issued after the date on which the regulations referred to in clause (1) take effect.

"(3) BOOK ENTRIES PERMITTED, ETC.—For purposes of this subsection, rules similar to the rules of section 103(j)(3) shall apply."

(3) DENIAL OF EARNINGS AND PROFITS ADJUSTMENT FOR INTEREST ON REGISTRATION-REQUIRED OBLIGATION NOT IN REGISTERED

FORM.—Section 312 (relating to earnings and profits) is amended by adding at the end thereof the following new subsection:

"(m) NO ADJUSTMENT FOR INTEREST PAID ON CERTAIN REGISTRATION-REQUIRED OBLIGATIONS NOT IN REGISTERED FORM.—The earnings and profits of any corporation shall not be decreased by any interest with respect to which a deduction is not or would not be allowable by reason of section 163(f), unless at the time of issuance the issuer is a foreign corporation that is not a controlled foreign corporation (within the meaning of section 957), a foreign investment company (within the meaning of section 124(b), or a foreign personal holding company (within the meaning of section 552) and the issuance did not have as a purpose the avoidance of section 163(f) of this subsection".

(4) EXCISE TAX ON ISSUERS OF REGISTRATION-REQUIRED OBLIGATIONS WHICH ARE NOT IN REGISTERED FORM.—

(A) IN GENERAL.—Subtitle D (relating to miscellaneous excise taxes) is amended by adding after chapter 38 the following new chapter:

"CHAPTER 39—REGISTRATION-REQUIRED OBLIGATIONS

"Sec. 4701. Tax on issuer of registration-required obligation not in registered form.

"Sec. 4701. TAX ON ISSUER OF REGISTRATION-REQUIRED OBLIGATION NOT IN REGISTERED FORM.

"(a) IMPOSITION OF TAX.—In the case of any person who issues a registration-required obligation which is not in registered form, there is hereby imposed on such person on the issuance of such obligation a tax in an amount equal to the product of—

"(1) 1 percent of the principal amount of such obligation, multiplied by

"(2) the number of calendar years (or portions thereof) during the period beginning on the date of issuance of such obligation and ending on the date of maturity.

"(b) DEFINITIONS.—For purposes of this section—

"(1) REGISTRATION-REQUIRED OBLIGATION.—The term 'registration-required obligation' has the same meaning as when used in section 163(f), except that such term shall not include any obligation required to be registered under section 103(j).

"(2) REGISTERED FORM.—The term 'registered form' has the same meaning as when used in section 163(f)."

(B) CONFORMING AMENDMENT.—The table of chapters for subtitle D is amended by inserting after chapter 38 the following:

"Chapter 39. Registration-required obligations."

(5) DENIAL OF DEDUCTION FOR LOSSES ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—Section 165 (as amended by this Act) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) DENIAL OF DEDUCTION FOR LOSSES ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—

"(1) IN GENERAL.—Nothing in subsection (a) or in any other provision of law shall be construed to provide a deduction for any loss sustained on any registration-required obligation unless such obligation is in registered form (or the issuance of such obligation was subject to tax under section 4701).

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) REGISTRATION-REQUIRED OBLIGATION.—The term 'registration-required obligation' has the meaning given to such term by section 163(f)(2) except that clause (iv) of subparagraph (A), and subparagraph (B), of such section shalll not apply.

"(B) REGISTERED FORM.—The term 'registered form' has the same meaning as when used in section 163(f).

"(3) EXCEPTIONS.—The Secretary may, by regulations, provide that this subsection and subsection (d) of section 1232 shall not apply with respect to obligations held by any person if—

"(A) such person holds such obligations in connection with a trade or business outside the United States,

"(B) such person holds such obligations as a broker dealer (registered under Federal or State law) for sale to customers in the ordinary course of his trade or business,

"(C) such person complies with reporting requirements with respect to ownership, transfers, and payments as the Secretary may require, or

"(D) such person promptly surrenders the obligation to the issuer for the issuance of a new obligation in registered form,

but only if such obligations are held under arrangements provided in regulations or otherwise which are designed to assure that such obligations are not delivered to any United States person other than a person described in subparagraph (A), (B), or (C)."

(6) DENIAL OF CERTAIN GAIN TREATMENT FOR GAINS ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—Section 1232 (relating to bonds and other evidences of indebtedness) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) DENIAL OF CAPITAL GAIN TREATMENT FOR GAINS ON CERTAIN OBLIGATIONS NOT IN REGISTERED FORM.—

"(1) IN GENERAL.—If any registration-required obligation is not in registered form, any gain on the sale or other disposition of such obligation shall be treated as ordinary income (unless the issuance of such obligation was subject to tax under section 4701).

"(2) DEFINITIONS.—For purposes of this subsection.

"(A) REGISTRATION-REQUIRED OBLIGATION.—The term 'registration-required obligation' has the meaning given to such term by section 163(f)(2) except that clause (iv) of subparagraph (A), and subparagraph (B), of such section shall not apply.

"(B) REGISTERED FORM.—The term 'registered form' has the same meaning as when used in section 163(f)."

(c) TECHNICAL AMENDMENTS.—

(1) Subparagraph (A) of section 103(b)(4) (relating to certain exempt activities) is amended by striking out "if each obligation issued pursuant to the issue is in registered form and".

(2)(A) Paragraph (1) of section 103(h) (relating to certain obligations must be in registered form and not guaranteed or subsidized under an energy program) is amended by

striking out subparagraph (A) and by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively.

(B) The subsection heading for subsection (h) of section 103 is amended by striking out "MUST BE IN REGISTERED FORM AND NOT" and inserting in lieu thereof "MUST NOT BE".

(3)(A) Subsection (j) of section 103A (relating to other requirements) is amended by striking out paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(B) Subparagraph (B) of section 103A(c)(2) (defining qualified mortgage issue) is amended by striking out "and (f) and paragraphs (2) and (3) of subsection (j)" and inserting in lieu thereof "(f), and (j)".

(c) Subparagraph (C) of section 103A(c)(2) is amended by striking out", and paragraph (1) of subsection (j)".

(D) Subparagraph (C) of section 103A(c)(3) (defining qualified veterans' mortgage bond) is amended by striking out "subsection (j)(1)".

(4) Subparagraph (A) of section 103A(c)(3) (defining qualified veterans' mortgage bond) is amended by striking out "in registered form".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to obligations issued after December 31, 1982.

(2) LONG-TERM U.S. OBLIGATIONS.—The amendment made by subsection (a) shall apply to obligations issued after the date of the enactment of this Act under the first section of the Second Liberty Bond Act.

(3) EXCEPTION FOR CERTAIN WARRANTS, ETC.—The amendments made by subsection (b) shall not apply to any obligations issued after December 31, 1982, on the exercise of a warrant or the conversion of a convertible obligation if such warrant or obligation was offered or sold outside the United States without registration under the Securities Act of 1933 and was issued before August 10, 1982. A rule similar to the rule of the preceding sentence shall also apply in the case of any regulations issued section 163(f)(2)(C) of the Internal Revenue Code of 1954 (as added by this section) except that the date on which such regulations the effect shall be substituted for "August 10, 1982". Temporary Income Tax Regulations § 5f.103-1 [issued in T.D. 7852, filed in the Office of the Federal Register on November 9, 1982, and published in the issue of the Federal Register for November 15, 1982, 47 Fed. Reg. 51361.]:

§ 5f.103-1 Obligations issued after December 31, 1982, required to be in registered form.

(a) Registration; general rule. Interest on a registration-required obligation (as defined in paragraph (b) of this section) shall not be exempt from tax notwithstanding section 103(a) or any other provision of law, exclusive of any treaty obligation of the United States, unless the obligation is issued in registered form (as defined in paragraph (c) of this section).

(b) Registration-required obligation. For purposes of this section, the term "registration-required obligation" means any obligation except any one of the following:

(1) An obligation not of a type offered to the public. The determination as to whether an obligation is not of a type offered to the public shall be based on whether similar obligations are in fact publicly offered or traded.

(2) An obligation that has a maturity at the date of issue of not more than 1 year.

(3) An obligation issued before January 1, 1983. An obligation first issued before January 1, 1983, shall not be considered to have been issued on or after that date merely as a result of the existence of a right on the part of the holder of such obligation to convert the obligation from registered form into bearer form, or as a result of the exercise of such a right.

(4) An obligation described in § 5f.163-1(c) (relating to certain obligations issued to foreign persons).

(c) Registered form—(1) General rule. An obligation is in registered form if—

(i) The obligation is registered as to both principal and any stated interest and transfer of the obligation may be effected only by the surrender of the old instrument and either the reissuance by the issuer of the old instrument to the new holder or the issuance by the issuer of a new instrument to the new holder, or

(ii) The right to the principal of, and stated interest on, the obligation may be transferred only through a book entry system (as described in paragraph (c)(2) of this section).

(2) Special rule for registration of a book entry obligation. An obligation shall be considered transferable through a book entry system if the ownership of an interest in the obligation is required to be reflected in a book entry, whether or not physical securities are issued. A book entry is a record of ownership that identifies the owner of an interest in the obligation.

(d) Effective date. The provisions of this section shall apply to obligations issued after December 31, 1982, unless issued on an exercise of a warrant for the conversion of a convertible obligation if such warrant or obligation was

offered or sold outside the United States without registration under the Securities Act of 1933 and was issued before August 10, 1982.

(e) Obligation first issued after December 31, 1982, where the right exists for the holder to convert such obligation from registered form into bearer form. [Reserved]

(f) Examples. The application of this section may be illustrated by the following examples:

Example (1). Municipality X publicly offers its general debt obligations to United States persons. The obligations have a maturity at issue exceeding 1 year. The obligations are registration-required obligation under § 5f.103-1(b). When individual A buys an obligation, X issues an obligation in A's name evidencing A's ownership of the principal and interest under the obligation. A can transfer the obligation only by surrendering the obligation to X and by X issuing a new instrument to the new holder. The obligation is issued in registered form.

Examples (2). Municipality Y issues a single obligation on January 4, 1983, in bearer form, to Bank M provided that (i) Bank M will not at any time transfer any interest in the obligation to any person unless the transfer is recorded on Municipality Y's records (except by means of a transfer permitted in (ii) of this example), and (ii) interests in the obligation that are sold by Bank M (and any persons who acquire interests from M) will be reflected in book entries. C, an individual, buys an interest in Y's obligation from Bank M. Bank M records such transfer by reflecting C's ownership on Bank M's books. Bank M receives the interest on principal payments with respect to C's interest in the obligation as agent for book entry system. Since C's interest can only be transferred through a book entry system, the obligation is considered issued in registered form. Interest received by C is excludable from gross income under section 103(a).

Example (3). Municipality Z wishes to sell its debt obligations having a maturity in excess of 1 year. The obligations are sold to Bank N, O, and P, all of which are located in Municipality Z. By their terms the obligations are freely transferable, although each of the banks has stated that it acquired the obligations for purposes of investment and not for resale. Obligations similar to the obligations sold by Municipality Z are traded in the market for municipal securities. The obligations issued by Municipality Z are of a type offered to the public and are therefore registration-required under paragraph 5f.103-1(b).

(g) Cross-references. See section 103A(j)(1) for the registration requirement of certain mortgage subsidy bonds issued after December 31, 1981, and § 6a.103A-1(a)(5) for the definition of registered form for such obligations issued after December 31, 1981, and on or before December 31, 1982. See also section 103(h) (requiring registration of certain energy bonds issued on or after October 18, 1979.